

REPORT OF EXAMINATION
OF THE
SAN FRANCISCO REINSURANCE COMPANY
AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed June 24, 2005

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San Francisco, California
April 1, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

SAN FRANCISCO REINSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 777 San Marin Drive, Novato, California 94998.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2003. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and

an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

This examination was conducted concurrently with the examinations of its parent, Fireman' Fund Insurance Company and its affiliates, Vintage Insurance Company and Associated Indemnity Corporation.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

The Company began business in 1964 as National Surety Corporation of California. In 1980, the Company's name was changed to San Francisco Insurance Company and to its present name in 1981.

Effective October 18, 1996, the Company ceased its underwriting operations, except for renewals, and is proceeding with the runoff of its existing business.

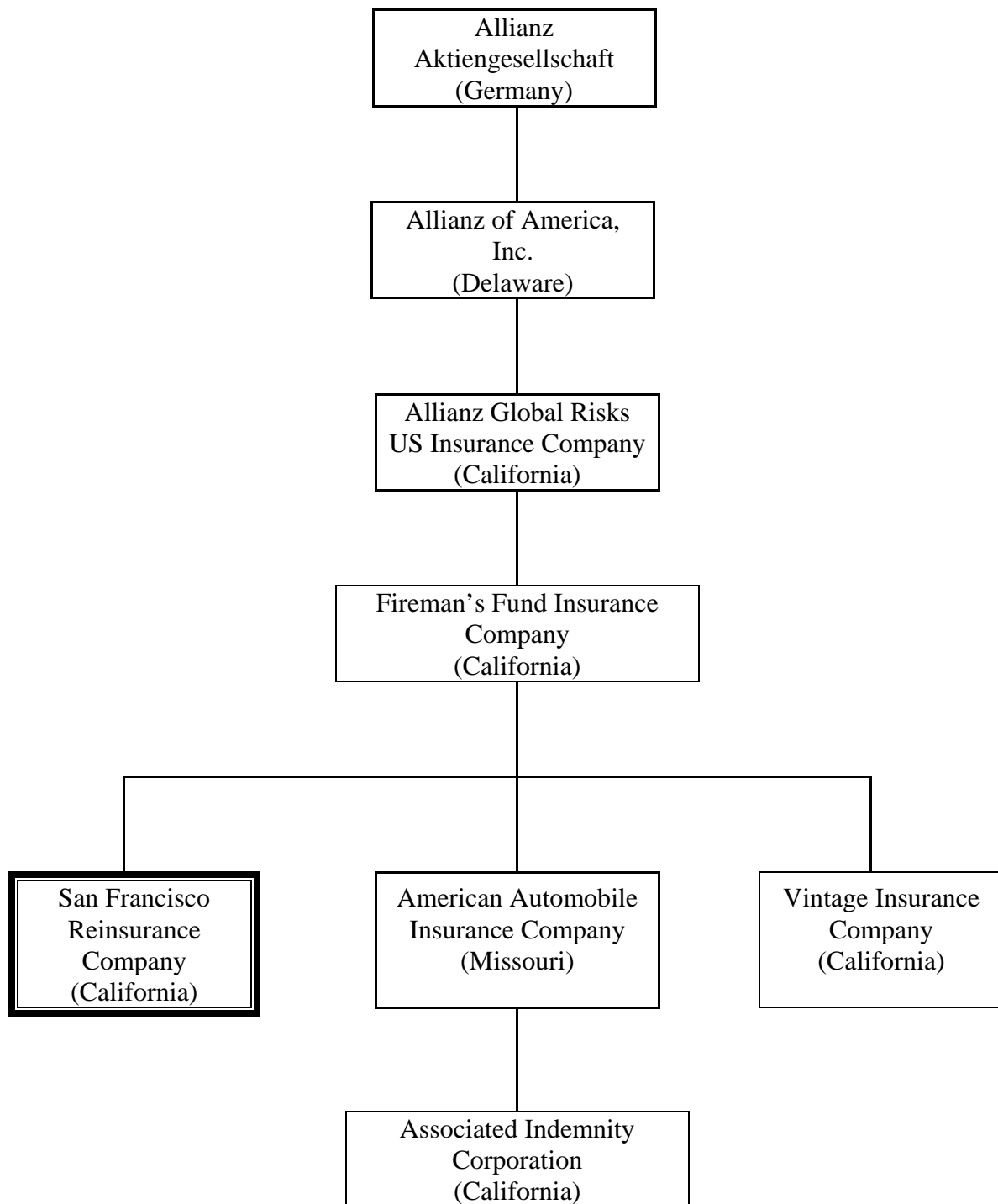
Capitalization

The Company is authorized to issue 60,000 shares of common stock with a par value of \$100. As of December 31, 2003, there were 39,215 shares outstanding.

All outstanding shares of the Company are owned by its parent company, Fireman's Fund Insurance Company (FFIC), a subsidiary of Allianz Global Risks US Insurance Company (AGR) (formerly Allianz Insurance Company or AIC), a subsidiary of Allianz of America, Inc. (AZOA), a subsidiary of Allianz Aktiengesellschaft Holding (Allianz AG).

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system. Allianz Aktiengesellschaft (Allianz AG), a corporation organized in Munich, Germany, is the ultimate controlling entity. The chart on the following page depicts the interrelationship of the Company and its California affiliates within the holding company system (all relationships are 100%):



The board of directors, which is comprised of five members, manages the business and affairs of the Company. Following are members of the board of directors and principal officers serving at December 31, 2003:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Earl C. Davis San Francisco, California	Senior Vice President Fireman's Fund Insurance Company
Peter Huehne (a) Tiburon, California	Executive Vice President and Chief Financial Officer Fireman's Fund Insurance Company
H. David Lundgren Tiburon, California	Executive Vice President Fireman's Fund Insurance Company
Janet S. Kloenhamer Larkspur, California	Senior Vice President, General Counsel and Corporate Secretary Fireman's Fund Insurance Company
Jeffrey H. Post (b) Novato, California	President and Chief Executive Officer Fireman's Fund Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
Jeffrey H. Post (b)	Chairman of the Board, President and Chief Chief Executive Officer
Earl C. Davis	President
Peter Huehne (a)	Executive Vice President and Chief Financial Officer
Janet S. Kloenhamer	Senior Vice President, General Counsel and Corporate Secretary
Linda E. Wright	Senior Vice President and Treasurer

- (a) Resigned in May, 2004 and was replaced by Charles Kavitsky, who previously held the position as President of Allianz Life Insurance Company.
- (b) Appointed CFO of Allianz of America (AZOA) effective January 1, 2004. Peter W. Presperin was appointed CFO of the Company effective January 1, 2004. Prior to this appointment, Mr. Presperin was the Director of Discontinued Operations at FFIC. He resigned as CFO of the Company in October 2004 and was replaced by Jill Patterson.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact insurance in Arizona, Arkansas, California, Colorado, Georgia, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Nebraska, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, and Washington.

The Company is licensed as a reinsurer in Puerto Rico and the following states: Alaska, Connecticut, Delaware, Florida, Hawaii, Kansas, Maine, Maryland, Massachusetts, Missouri, Montana, Nevada, New Hampshire, New Jersey, Pennsylvania, Rhode Island, South Dakota, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming.

Effective October 18, 1996, the Company ceased its underwriting operations, except for renewals, and is proceeding with the runoff of its existing business.

REINSURANCE

The Company had no assumed or ceded premium written during the period covered by this examination, and maintains no liability for assumed losses or loss adjustment expenses as of December 31, 2003.

Retroactive Reinsurance

On September 30, 2002, the Company entered into a retroactive reinsurance contract whereby it ceded all net carried reserves totaling \$4.3 million related to asbestos and environmental (A&E) claims to its ultimate parent, Allianz Aktiengesellschaft Holding (Allianz AG). The Company received approval from the California Department of Insurance to account for the transaction as a prospective arrangement. Under prospective accounting, the Company recorded ceded premium of \$4.3 million and ceded losses of \$4.3 million, with no impact on net income. The ceded losses are reflected on the statement of admitted assets, liabilities and surplus as a decrease in net loss reserves.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, recommendations for improving the Company's information systems controls were developed and presented to the Company. The recommendations covered areas such as logical security, physical security and program changes. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders from December 31, 1999
through December 31, 2003

Reconciliation of Examination Changes as of December 31, 2003.

Statement of Financial Condition
as of December 31, 2003

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 211,296,805	\$	\$ 211,296,805	(1)
Common stocks	0		0	(2)
Cash on deposit	24,995,655		24,995,655	
Other invested assets	28,677,835		28,677,835	(2)
Receivable for securities	3,158		3,158	
Investment income due and accrued	2,882,271		2,882,271	
Premiums and agents' balances in course of collection	(635,350)		(635,350)	
Amount recoverable from insurers	1,192,646		1,192,646	
Funds held by or deposited with reinsured companies	654,732		654,732	
Net deferred tax asset	1,674,137	1,135,538	538,599	
Furniture and equipment, including health care delivery assets	<u>(304)</u>	<u>(304)</u>	<u>0</u>	
Total assets	<u>\$ 270,741,585</u>	<u>\$ 1,135,234</u>	<u>\$ 269,606,351</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 21,713,199	(3)
Reinsurance payable on paid loss and loss adjustment expenses			1,997,910	
Other expenses			2,407,007	
Taxes, licenses and fees			34,311	
Current federal and foreign income taxes			4,425,777	
Funds held by company under reinsurance treaties			94,427	
Provision for reinsurance			990,798	
Payable to parent, subsidiaries and affiliates			173,433	
Aggregate write-ins for liabilities			<u>183,307</u>	
Total liabilities			32,020,169	
Common capital stocks	\$ 3,921,500			
Gross paid-in and contributed surplus	191,633,647			
Unassigned funds (surplus)	<u>42,031,035</u>			
Surplus as regards policyholders			<u>237,586,182</u>	
Total liabilities, surplus and other funds			<u>\$ 269,606,351</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses incurred	\$ (554,004)	
Loss expenses incurred	270,217	
Other underwriting expenses incurred	<u>377,968</u>	
Total underwriting deductions		<u>94,181</u>
Net underwriting loss		(94,181)

Investment Income

Net investment income earned	\$13,054,275	
Net realized capital gains	<u>703,571</u>	
Net investment gain		<u>3,757,846</u>
Net income before federal and foreign income taxes		13,663,665
Federal and foreign income taxes incurred		<u>3,960,543</u>
Net income		<u>\$ 9,703,122</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		\$227,045,139
Net income	\$9,703,122	
Change in net unrealized capital gains	779,587	
Change in net unrealized foreign exchange capital loss	(58,771)	
Change in net deferred income tax	803,698	
Change in nonadmitted assets	(1,135,234)	
Change in provision for reinsurance	<u>448,641</u>	
Change in surplus as regards policyholders		<u>10,541,043</u>
Surplus as regards policyholders, December 31, 2003		<u>\$237,586,182</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

Surplus as regards policyholders, December 31, 1999, per Examination	\$228,766,152
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	Gain in Surplus	Loss in Surplus
Net income	\$57,521,858	\$
Net unrealized capital gains	58,648	
Change in net foreign exchange capital gains	59,672	
Change in net deferred income tax	1,173,137	
Change in nonadmitted assets		1,134,026
Change in provision for reinsurance	390,341	
Change in excess of statutory reserve over statement reserves	321,000	
Cumulative effect of changes in accounting principles	501,000	
Dividends to stockholders (cash)		50,071,600
Total gains and losses	\$60,025,656	\$ 51,205,626

Net decrease in surplus as regards policyholders	8,820,030
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Surplus as regards policyholders, December 31, 2003, per Examination	\$237,586,182
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Reconciliation of Examination Changes
as of December 31, 2003

	<u>Per Company</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
<u>Assets</u>				
Common Stocks	\$23,680,134	\$ 0	\$(23,680,134)	(2)
Other invested assets	0	23,680,134	<u>23,680,134</u>	(2)
Net change to surplus			0	
Surplus as regards policyholders, December 31, 2003, per Company			<u>237,586,182</u>	
Surplus as regards policyholders, December 31, 2003, per Examination			<u>\$237,586,182</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Custodian Agreement (Agreement) dated October 1, 1998 between the Company and Mellon Trust of California does not adhere to the guidance regarding Custodial and Safekeeping Agreements provided by the National Association of Insurance Commissioners' Financial Examiners Handbook in the following areas:

- a. The Agreement states "At its option, the Custodian may commingle any assets deposited hereunder with assets held by the Custodian on behalf of others". The agreement should clearly state that certificated securities of the insurance company shall be held separate from all other securities or in a fungible bulk. Those securities held in a fungible bulk by the custodian, in a clearing corporation, or in the Federal Reserve book-entry system, shall be separately identified on the custodian's official records as being owned by the insurance company.
- b. The Agreement did not contain a clause requiring that should the Agreement be terminated, or if 100% of the account assets in any one custody account are withdrawn, the custodian shall provide written notification, within three business days of the termination or withdrawal, to the insurer's domiciliary commissioner
- c. The Agreement did not contain a clause requiring that the custodian and its agents, upon reasonable request, be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system that the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control
- d. The Agreement did not contain a clause requiring that the custodian secure and maintain insurance protection in an adequate amount.

It is recommended the Company revise its Agreement with Mellon Trust of California to include provisions recommended by the National Association of Insurance Commissioners' Financial Examiners Handbook. It is also recommended the Company submit the revised Agreement to the California Department of Insurance (CDI) for approval.

(2) Common Stocks and Other Invested Assets

The Company classified Allianz Cash Pool LLC, a limited liability company, as common stock and reported it on Schedule D, Part 2, Section 2. SSAP No. 48, paragraph 6 of the NAIC Accounting Practices and Procedures Manual specifies that investments in joint ventures, partnership and limited liability companies be reported on Schedule BA, Other Invested Assets. The value of the Allianz Cash Pool LLC at December 31, 2003 was \$23,680,134. This asset has been reclassified to Other Invested Assets per examination. It is recommended that the Company classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

(3) Losses and Loss Adjustment Expenses

The CDI, pursuant to California Insurance Code (CIC) Section 733(g), retained a consulting actuary for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2003. The results of the evaluation indicated that the Company's loss and loss adjustment expense reserves were reasonably stated.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 7): As the result of the review of the Company's information system controls, recommendations for improving the Company's information systems controls were developed and presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Comments on Financial Statement Items - Bonds (Page 12): It is recommended the Company revise its Custodian Agreement with Mellon Trust of California to include provisions recommended by the NAIC Financial Examiners Handbook. It is also recommended the Company submit the revised Agreement to the California Department of Insurance (CDI) for approval.

Comments on Financial Statement Items - Common Stocks and Other Invested Assets (Page 13): It is recommended that the Company classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

Previous Report of Examination

Accounts and Records - (Page 7). It was recommended the Company institute policies and procedures to analyze and evaluate general ledger accounts on a regular basis. The Company performed a review of general ledger accounts and implemented controls to ensure that the general ledger accounts are reviewed and reconciled on a timely basis.

Comments on Financial Statement Items - Bonds, Stocks and Short-term Investments (Page 11): It was recommended the Company obtain approval from the CDI of its Custodial Agreement with the Mellon Bank of California. The current Custodial Agreement did not contain provisions recommended by the NAIC Financial Examiners Handbook. Accordingly, it is recommended the Company submit the revised Agreement to the CDI for approval.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/S/

Gordon M. Curtis, CFE, CISA
Examiner-In-Charge
Department of Insurance
State of California